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BCE caught between banks and Teleglobe bondholders

By ERIC REGULY
Thursday, April 11, 2002 – Print Edition, Page B16

On Bay Street, there is one big question: How much is Jean Monty going to cost us, and if it's a lot, is it going to cost the BCE boss his job?

A dozen or so banks and investment dealers that either lent money to BCE's near-lifeless Teleglobe unit or underwrote its bonds -- $2.5-billion (U.S.) of debt in total -- are preparing for a high-risk game of brinkmanship with Mr. Monty and his advisers, among them the financial restructuring specialists at Wall Street's Lazard. The negotiations promise to get ugly for the simple reason, not widely known, that the bank debt (about $1.2-billion) and the bond debt (about $1.3-billion) rank pari passu, that is, both are on equal footing.

The fact that the banks and the bondholders theoretically will swim or sink together adds an unusual and dangerous twist to BCE's efforts to overhaul Teleglobe's crippling debt and salvage Mr. Monty's reputation. Imagine if the banks had first call, and the bondholders came second. BCE's strategy would then be simple: Give the banks 100 cents on the dollar, or close to that amount, and make the bondholders take most of the pain. After all, who does BCE need more in the long run -- the goodwill of some of Canada's and the world's biggest banks, or the goodwill of a bunch of faceless bondholders? Under this scenario, there is no debate.

Under the equal-treatment-for-all scenario, there is. If BCE tries to force the bondholders to "take a haircut," to borrow an expression from the fun-loving debt fixer-uppers, so that the

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banks don't, you can bet the bondholders will hire a Delta Force company of lawyers to convince BCE otherwise. This is Mr. Monty's nightmare: BCE fighting with both classes of debtholders, who are in turn fighting with each other. The headlines, the expense, the horrendous commitment of management time and the uncertain outcome could prove extremely damaging to BCE and its shareholders.

There is another course of action BCE: Negotiate with no one. Walk away from the whole rotting Teleglobe mess and let the debtholders fight among themselves for what little asset value remains. The direct financial cost to BCE would be zero because BCE guarantees none of Teleglobe's debt.

The cost to Mr. Monty's reputation, though, could be horrendous. A clean break from Teleglobe would not only alienate the banks, it would come as a brutal admission that Mr. Monty's biggest strategic move, the purchase of all of the outstanding shares of Teleglobe for $7.4-billion (Canadian) in late 2000, was a colossal mistake. At that point, he might have to fall on his sword.

How did Mr. Monty go from hero to hapless so quickly? In a word, Teleglobe.

In early 2000, Mr. Monty was on top of the world. His big score was unloading BCE's investment in Nortel near the peak of the market. If he had stopped there, he might have gone down as god's gift to investors. Instead, he bought out the majority stake in Teleglobe, the international communications network that had launched a multibillion-dollar upgrade of its system to integrate the transmission of voice, data, Internet and video. Less than a year after the purchase, Teleglobe was in trouble. Prices and revenue had fallen as the market collapsed and competition increased. Two competitors, Global Crossing and 360networks, would eventually go into bankruptcy protection.

Faced with a rapidly deteriorating business, Teleglobe took an axe to its capital expenditure program, fired hundreds of employees and took a $90-million pretax charge in August of 2001. In its third-quarter report, Teleglobe said given that it "does not have sufficient funds available from its cash flow to meet its obligations to make necessary capital expenditures . . . and pay other operating expenses, it relies on BCE Inc. to provide additional funding to meet these obligations."

This is the time when BCE analysts, shareholders and the board of directors should have been asking the tough questions, and apparently didn't. Here's one: If Teleglobe was in crisis, as was obvious by the second half of last year, why did BCE continue

to pump a small fortune into it? Shouldn't the financial overhaul of Teleglobe have started then? Was BCE not just throwing good money after bad?

The Teleglobe report states that BCE had injected $714-million (U.S.) into Teleglobe by Sept. 30. BCE officials say the bail-out figure rose to $900-million by the end of the year, at which time Mr. Monty said that an additional $300-million or so may have to follow (it's not clear whether that last amount, or perhaps more, has been spent). One positive result, at least as far as the bondholders were concerned, was that the bond prices held fairly firm. That all changed in recent weeks when Teleglobe debt got downgraded to junk, BCE reiterated its stance of not guaranteeing any of Teleglobe's debt, and another big BCE unit, Emergis, issued a profit warning. BCE shares plummeted. Teleglobe bonds fell even faster and were last quoted at about 20 cents on the dollar.

The sinking BCE shares suggest that Mr. Monty will lose his nerve on Teleglobe. The market wants BCE to stop funding Teleglobe and excise it from BCE's books. At this stage, this option is unlikely because BCE needs the banks. It has seen the pressure they have put on Nortel -- yesterday, the banks renewed the company's credit line, but cut down its size and raised its interest costs -- and would fear similar treatment down the road. BCE would also need the banks to help it finance the purchase of the 20 per cent of Bell Canada that is owned by SBC Communications, a U.S. phone company. SBC has the option to force BCE to buy back the 20 per cent later this year.

The banks have a hidden weapon too. If Mr. Monty threatens to make them eat the Teleglobe loans, the banks could threaten to scrap their telecommunications and financial software contracts with Bell Canada, Emergis and other BCE companies. The Big Six Canadian banks and their Bay Street division are among the biggest buyers of BCE services.

Still, don't assume the banks have already won the game with Mr. Monty.

A lot could happen between now and mid-July, when the $1.2-billion bank line comes due. The bondholders could organize a formidable attack. BCE could decide to sever all ties to Teleglobe and let it sink without a trace.

But we already know one thing for sure. The centrepiece of Mr. Monty's strategic diversification is a dud. If Teleglobe's financial overhaul proves disastrous for BCE, Mr. Monty's job may be on the line.
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BCE's Teleglobe Debt Holders Consider Legal Actions (Update1)

(Updates with holdings in second paragraph, lawyer comment in fourth, BCE comment in seventh, background in ninth.)

New York, April 16 (Bloomberg) -- Institutional investors holding debt issued by BCE Inc.'s Teleglobe unit have banded together and hired a law firm after the company said it may stop funding the money-losing unit or restructure its debt.

The group, which holds as much as $500 million of Teleglobe's $1.2 billion of debt in both the U.S. and Canada, is prepared to take legal action to protect its investments, said Evan Flaschen, a lawyer with Boston-based Bingham Dana LLP, which was hired by the group. He declined to name the investors.

BCE, Canada's largest telecommunications company, said on April 8 it had begun a review of alternatives for Teleglobe, including possible business combinations, restructuring and alternative financing. It plans to release details of any action on April 24, when it releases first-quarter results.

''We want them to know before then that we're out here and we're organized,'' Flaschen said. ''We believe BCE made a number

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of representations as supporting Teleglobe, and we hope and trust they will continue to support Teleglobe.''

Teleglobe operates an international fiber-optic and satellite network carrying Internet data and voice.

BCE spokesman Don Doucette declined to comment on the debt holders' statement. Shares fell 81 Canadian cents, or 3.3 percent, to C$23.97 ($15.16) in late trading.

Cut to Junk

''We have merely announced that we're looking at our options,'' he said. ''We've not made any concrete decisions, and they'll be discussed on April 24.''

Earlier this month, Moody's Investors Service cut Teleglobe's credit rating to junk on concern it may default without support from its parent. The credit rating agency reduced its rating to ''Ba3'' from ''Baa3'' on the $1.2 billion of debt.

BCE will have to treat its Teleglobe bondholders the same way as holders of its $1.25 billion bank debt in any restructuring, the Globe and Mail reported Thursday. That means it can't force bondholders to accept a plan that would give them less than the

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banks, the paper said.

Bingham Dana said in its statement that the debt holders have long viewed BCE and Teleglobe as parts of the same organization and will ''review their alternatives carefully.''

Flaschen said he expects more institutional investors will join the group.

''The company's press release caught a lot of people by surprise, so it wasn't hard to get organized and find each other quickly,'' he said.

--Kevin Bell in the Toronto newsroom, (416) 203-5718 or kbell2@Bloomberg.net. Editor: MacKay.

Story illustration: For a chart of returns from holding BCE shares, see BCE CN <Equity> TRA <GO> .

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